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SUBJECT: IMF AND FINANCE MINISTRY NOT PURSUING STAND-BY
AGREEMENT; TIME TO MOVE FORWARD WITH TFCA

1. (SBU) Summary: Guatemala and the IMF have decided not to proceed with a new stand-by agreement (SBA). The IMF is insisting on a commitment to pass fiscal reform legislation by a given date, which Guatemala does not believe it can guarantee in the current congressional environment. Both sides agree that the macroeconomic situation is in good shape and that an SBA is not needed. Under these circumstances, we believe the time has come to approve Guatemala's eligibility for a debt-for-nature swap under the Tropical Forest Conservation Act. End summary.

No Date Certain for Fiscal Reform, So No SBA

2. (SBU) An IMF staff mission that arrived in February for the 2005 Article IV consultation failed to reach agreement with Guatemala's Ministry of Finance on a new stand-by agreement (SBA). IMF ResRep Erik Offerdal told EconCouns that the Fund was pleased by what it found during the visit, but the two sides could not reach agreement on a timetable for tax reforms. Offerdal said that the IMF insisted that a firm date be established for passing tax reforms that would lead to revenue collections equivalent to at least 12% of GDP. Finance Minister Bonilla would not commit to such a date on grounds that the government could not force the Congress, which it doesn't control, to do its bidding. She felt that Guatemala had no need for an SBA other than as a seal of approval that might lower borrowing costs. Setting a date for tax reform and then missing it because of congressional politics would send a worse message to markets than not having an SBA at all. Offerdal said the Fund mission had sympathy for Bonilla's position but had no flexibility on getting a near-term date certain for passing tax reform legislation.

Fund Agrees to Accentuate the Positive...

3. (SBU) Offerdal said that the Fund agreed to downplay the lack of agreement on an SBA and speak well of Guatemala's performance in its public statements. The Fund's subsequent press release did not mention an SBA at all, noting instead that economic performance "had improved," "international reserves rose to record levels," "the budget deficit was reduced sharply," while "early actions have aimed at addressing corruption; reducing the size of the military; and strengthening the public finances." The release also notes that the "Guatemalan financial system has been strengthened considerably in recent years." The only comment that wasn't positive was that "inflation drifted upward to over 9 percent," due both to oil prices and "relatively easy monetary conditions."

...As Results Exceed Expectations

4. (U) The latest data we have seen for 2004 indicates net fiscal revenue collections of 10.3% of GDP, which we understand would have been a couple of tenths of a percentage point higher except that the Ministry of Finance made considerable progress on clearing Portillo-era arrears of value added tax rebates to exporters. The fiscal deficit was 0.3%, well below original expectations and reflected better controls over spending. The targets for 2005 are 10.5% for revenues and 1.8% for the deficit, with the deficit to be reduced to 1.5% and social spending to increase if and when additional revenues are mobilized.

Comment: Moving Forward with the TFCA

5. (SBU) We understand that Washington agencies were expecting an SBA to be signed early this year and were waiting for that to happen before approving Guatemalan eligibility for a debt-for-nature swap under the Tropical Forest Conservation Act. Now that an SBA is not on the horizon but the Fund is nevertheless satisfied with Guatemala's economic performance, we urge Washington to wait no longer and move ahead with TFCA approval, preferably in advance of the presentation of the staff report on the Article IV consultation to the Board, which we understand is being delayed until May. (Guatemala has not yet been told

about the Article IV delay, so we ask that this information
be held closely for now.)
HAMILTON